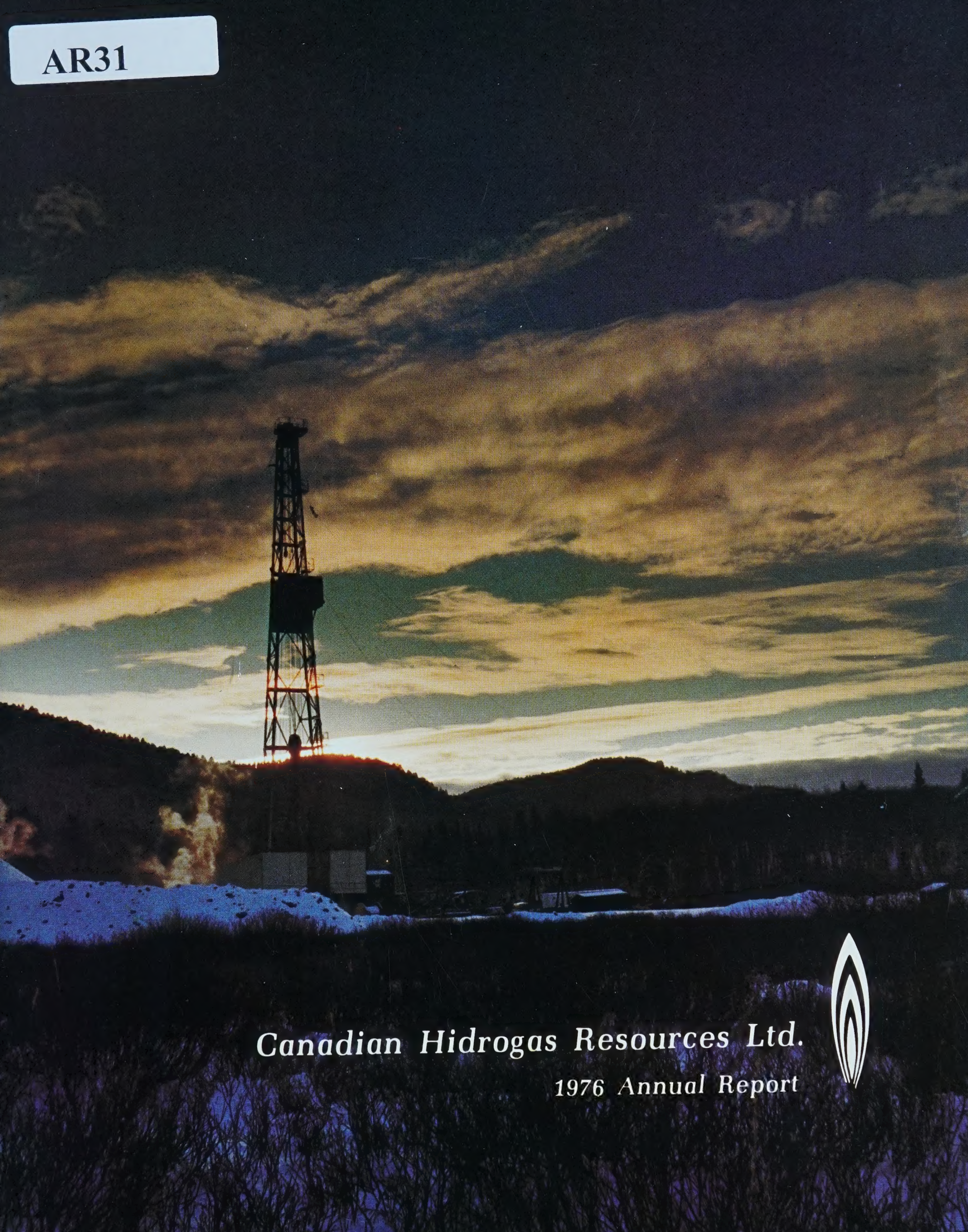


Canadian Hidrogas Resources Ltd.

1976 Annual Report

ghts:

	1976	1975
erating revenues	$3,813,000	$1,760,000
om on-going		
	$ 698,000	$ 158,000
	26¢	6¢
(loss) before		
ary item	$ 243,000	$ (478,000)
	9¢	(18¢)
(loss)	$ (315,000)	$ (478,000)
	(12¢)	(18¢)
:		
oduction — barrels	410 000	254 000
age	1 125	695
production — mcf	537 000	89 000
age	1 470	245
probable		
s — barrels	17 619 000	16 363 000
probable		
s reserves — mcf	27 489 000	24 731 000
operties:		
s, including		
interests	177 421	209 639
	35 380	49 572
d — gross	33.0	58.0
— net	15.7	28.0

Canadian Hidrogas Resources Ltd.

Directors:
Evan W. G. Bodrug
Arthur F. Coady
Larry S. Heald
Robert C. Jeal
Henry W. Klassen
Benjamin J. McConnell
Robert E. McLennan

Officers:
Evan W. G. Bodrug — Chairman of The Board
Robert E. McLennan — President
Robert C. Jeal — Controller
Larry S. Heald — Secretary

Head Office:
Suite 1000
610 - 8th Ave. S.W.
Calgary, Alberta T2P 1G5

Transfer Agent:
National Trust Company Limited
Calgary, Toronto and Vancouver

Bank:
Bank of Montreal,
Calgary, Alberta

Auditors:
Deloitte, Haskins & Sells
Calgary, Alberta

Shares Listed (share symbol — CHS)
Toronto Stock Exchange
Vancouver Stock Exchange
Alberta Stock Exchange

chairman's report to the shareholders:

For the past several years your Company has been involved in a variety of activities including the wholesaling of propanes and butanes, underground storage, railway tank car rolling stock and distribution of various products to the automotive industry. While carrying on these activities the Company has steadily built up an oil and gas producing and development operation. During the more recent past it became clear that the Company would benefit to a greater degree if all other activities were curtailed and we concentrated on the development and production of resources. This has now been accomplished.

With this accomplished it became necessary to have strong operational leadership. Your Company has been successful in obtaining the services of Robert E. McLennan who took the position of President of Canadian Hidrogas Resources Ltd. on July 1, 1976. Bob is a professional geologist and has had some eighteen years experience in all phases of exploration, development and production of oil and gas as well as the economics relating to these activities. We welcome Bob to our Company and are certain that he will prove to be an outstanding asset and, as such, a benefit to the Company and its shareholders.

Respectfully submitted,

Evan Bodrug

Evan W. G. Bodrug
Chairman of the Board

president's report to the shareholders:

The consolidated operations of Canadian Hidrogas Resources Ltd. include the activities of the parent company and those of its wholly-owned subsidiaries, Hidrogas Limited, Hidrogas Incorporated, Pet Chem Distributing Ltd., Hidrogas Inc., and its 75 percent owned subsidiary, Vanalta Resources Ltd. Oil and gas exploration, development and production are carried on by the parent company and two subsidiaries, Hidrogas Limited and Vanalta Resources Ltd.

The on-going operations of the Company showed substantial progress in the fiscal year ending August 31, 1976. Revenues of $3,813,000 more than doubled $1,760,000 in the prior year and provided working capital from operations of $698,000 or 26 cents per share — a more than threefold improvement over $158,000 last year. However, the large extraordinary loss, including writedown of inventories, on disposal of assets of discontinued operations more than offset a net income of $243,000 and resulted in a net loss of $315,000 or 12 cents per share for the year. With the disposal of these unprofitable activities behind us, we look forward to continued improvement in our on-going oil and gas operations.

During the 1976 fiscal year, Company working interest production increased

substantially. Crude oil production was up 60 percent from 254 000 barrels to 410 000 barrels — an annual daily average of 1 125 barrels per day. Lloydminster accounted for this improvement in spite of marketing problems which resulted from government export restrictions to the United States. Natural gas production increased from 89 000 mcf to 537 000 mcf. The North Coleman gas field commenced production in late November 1975 and fifteen new wells in the Princess gas field were put on stream through the new gas plant in late December 1975.

The Company participated in 33 gross wells or 15.7 net wells during the year, including the non-operated North Coleman well which was drilling at the end of the period. The Company operated the other 32 wells of which 31 are productive. At Lloydminster, eight oil wells were re-entered and two new oil wells and one dry hole were drilled in which the Company has a 100 percent interest; one oil well was drilled in which the Company has a 50 percent interest and four oil wells were drilled under a farmout agreement with a major utility company which permits the Company to back-in to a 50 percent interest after payout. At Princess, fifteen gas wells were drilled in which the Company has a 25 percent interest. At Leahurst, one gas well was drilled in which the Company has a 42.5 percent interest.

At North Coleman, the exploratory incentive earning well through the producing Mississippian and Devonian gas reservoirs to test the postulated underlying Carbondale plate commenced drilling in July.

The Company has a 5.034 percent working interest in this venture which is presently proceeding below the existing reservoirs. The well can provide operational back-up when existing wells are serviced and the sales contract will be increased to accommodate any new production that is discovered.

Since August 1976 the Company, as operator, has completed five more gas wells at Princess. Of these, four 25 percent interest wells began production in December and the fifth 20 percent interest well will be placed on stream in the immediate future. As soon as drilling equipment becomes available, the Company will drill six option wells at Lloydminster under the farmout agreement with the major utility company and will operate a Viking test on the 43 680 acre permit at Portreeve, Saskatchewan in which the Company has a 10 percent interest.

In addition to drilling, the Company consolidated its land position in its pursuit of development of early production from its properties. The decrease in the Company's acreage reflects the sale of the problematical Medicine Hat properties and a substantial reduction in acreage which occurred when Vanalta surrendered its interest in several large blocks of land surrounding the Deadwood gas field near Manning in northern Alberta. Prior drilling by Vanalta and others had indicated limited potential for these tracts. At Alberta Crown sales since August 1976, the Company acquired an interest in three leases at Lloydminster; one lease at Manyberries and one lease at Armada, which Vanalta purchased.

The reserves of the Company have been evaluated by a recognized independent consultant. Detailed property by property appraisals established total year end proven and probable working interest oil reserves of 17 619 000 barrels before deduction of royalties for a Company net of 14 407 000 barrels after deduction of royalties. The proven and probable working interest gas reserves amount to 27 489 000 mcf before deduction of royalties for a Company net of 15 617 000 mcf after deduction of royalties.

The consultant's appraisal indicates the proven reserves alone will generate an undiscounted net revenue of more than $80 million with a before tax present worth value, discounted at 12 percent, of some $26 million. The proven reserves were subdivided into categories according to their producing status and whether additional capital expenditures were required to produce the reserves at the forecast rates.

Subsequent to the year end, the Company consolidated its capital

debt which made an initial net increase of $2.3 million available for 1976-1977 capital programmes. We have started to draw-down this credit in programmes to develop properties which will contribute substantially to Company profits, particularly as increased wellhead prices for oil and gas are received.

Capital spending plans will be directed towards accomplishing the goals and objectives of the Company for profitability and long-term growth. Briefly these are:

— Pursue development of early production from all Company properties as increased returns to the producer are realized.
— Continue development of the Company's heavy oil capability through maintaining an inventory of low risk locations as improved recovery technology makes this source of energy a more important factor in the future supply of petroleum.
— Seek more diversification in drilling, development and acquisition of new properties and thereby reduce the Company's sensitivity to seasonal fluctuations experienced in the market for heavy oil.

Vigorous efforts to achieve these goals are under way.

The leases acquired at Alberta Crown sales in November and December 1976 consolidate the Company's land position on the Blackfoot lease in the Lloydminster field, Vanalta's land position at Armada, and increase the Company's holdings at Manyberries, the scene of recent industry drilling activity. The Company is waiting for rigs to drill seven wells — six at Lloydminster and one at Portreeve in southwestern Saskatchewan. The Lloydminster wells will establish low risk undrilled future development locations. The well at Portreeve will fulfill work commitments and allow lease conversion on the 43 680 acre permit where four Milk River sandstone wells have been completed. Late last month the Saskatchewan government announced increased field gate values for natural gas produced in that Province.

Government intervention, which has overshadowed other developments in the oil and gas industry for some time, appears to be diminishing. The National Energy Board's hearing in October on Canadian crude oil supply and demand resulted in interim relief from restrictions on the export of heavy crude oils starting in January. The Board's final report to be published in March is expected to establish a more certain policy to handle the separate licensing of heavy crude oil exports to the United States.

Governments are allowing increased returns to the producer as the cost of all forms of energy rise. Saskatchewan has announced increased gas prices and Alberta has amended its royalty regulations to stimulate the institution of certain enhanced recovery mechanisms, including thermal.

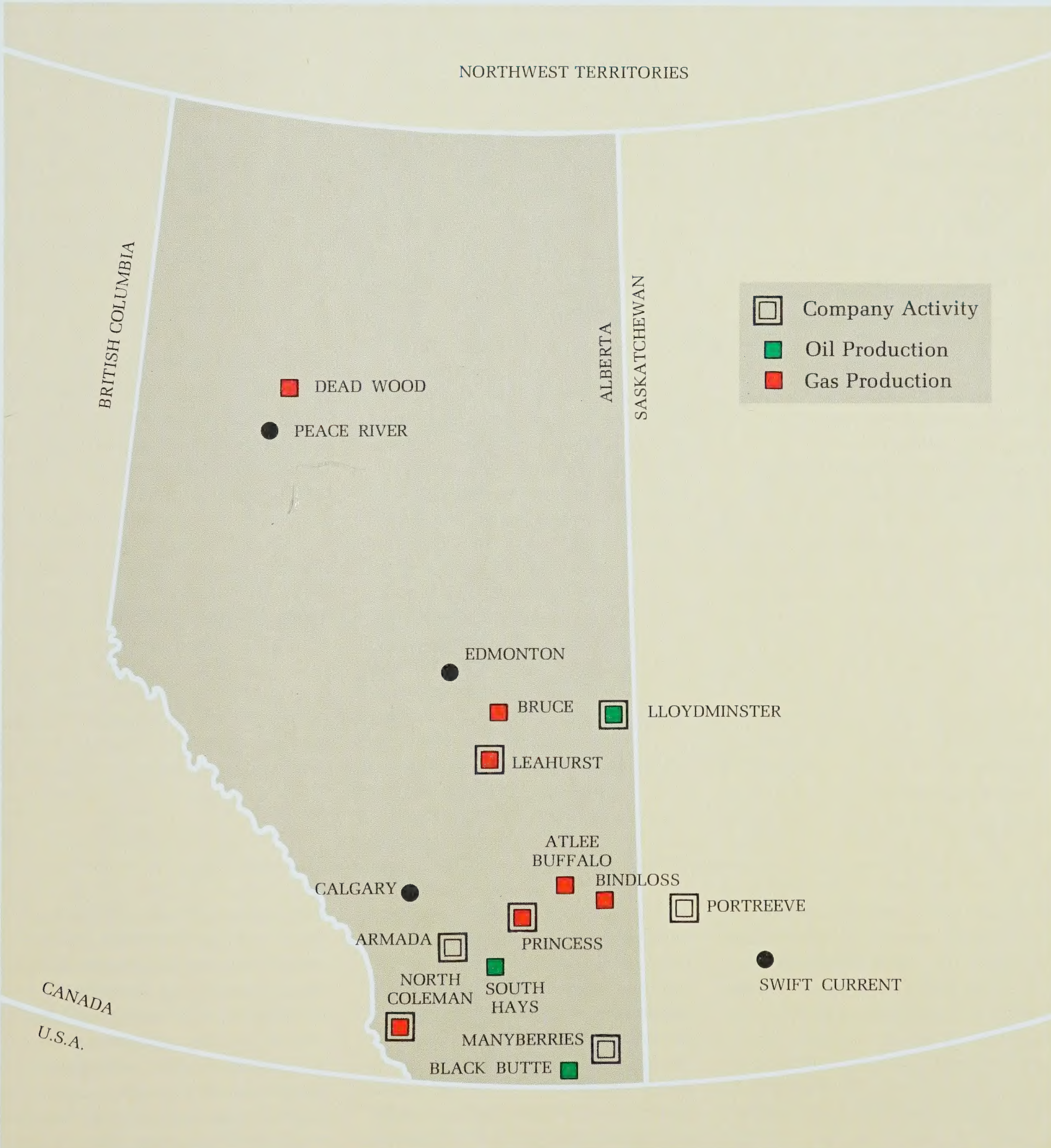
The Company acknowledges the contributions and efforts of our employees in building a strong operating structure. The Company is in an excellent position to expand its programmes as new opportunities present themselves. The Company looks to the challenges ahead with optimism in anticipation that more public knowledge of oil and gas industry endeavours will provide the investment climate that will permit the Company to achieve its goals.

Respectfully submitted

R. E. McLennan
President

January 24, 1977
Calgary, Alberta

company areas of activity



review of operations

Resource Properties

	Acreage on August 31			
	1976		1975	
	gross (1)	net	gross (1)	net
Oil and Gas Properties				
Alberta	116 066	29 387	148 657	43 579
Saskatchewan	58 665	4 648	58 292	4 648
Montana	2 690	1 345	2 690	1 345
Total	177 421	35 380	209 639	49 572
Alberta Coal Leases (2)	1 280	1 280	1 280	1 280
TOTAL ACREAGE	178 701	36 660	210 919	50 852

(1) including royalty interests
(2) 640-acre lease and 640-acre lease applied for

The land holdings of the Company shown in the table reflect the Company's endeavour to consolidate its mineral acreage. The Company's Alberta acreage decreased when its interests at Medicine Hat were sold and when several large low potential tracts at Manning, north of Peace River, were surrendered by Vanalta.

The status of the coal leases near Turner Valley remained unchanged pending clarification of the Alberta government's policy with respect to coal.

Drilling

	Fiscal Year Ending August 31, 1976					
	Gross Wells			Net Wells		
	Gas	Oil	Dry	Gas	Oil	Dry
Lloydminster	—	15	1	—	10.50	1.00
Princess	15	—	—	3.75	—	—
Leahurst	1	—	—	0.43	—	—
North Coleman (1)	1	—	—	0.05	—	—
TOTAL	17	15	1	4.23	10.50	1.00

(1) The North Coleman well commenced drilling in July 1976 and operations are still proceeding.

The Company participated in 33 gross wells amounting to 15.7 net wells during the report period. The Company's drilling activities were directed towards the optimum development of producing properties and increasing the inventory of low risk undrilled future development locations.

At Lloydminster eight oil wells were re-entered for increased production and eight wells were drilled to define the limits of the productive oil pools. Our inventory of undrilled development locations at Blackfoot and South Lloydminster has been increased and only one dry hole has resulted. At Princess, fifteen gas wells were drilled to fill the Company's, and its partners, ownership capacity in the new gas plant. Remaining low risk development locations will be drilled to fully utilize our ownership capacity and take economic advantage of any unused plant capacity that may be available from other owners. At

Leahurst, gas was encountered in the Viking and Basal Quartz, in a well drilled to expedite early production from this previously unproductive acreage.

The North Coleman well commenced drilling in July 1976. This is the only non-operated well in which the Company participated. While the well was drilling at the end of the report period, it has since penetrated the producing Mississippian and Devonian gas reservoirs and has been classified as a gas well in the drilling summary table. This exploratory incentive earning well is proceeding to test the potential of the deeper horizons. The well will also be available in the event that operating back-up is required when an existing producing well is serviced.

Production

	Fiscal Year	
	1976	1975
Crude oil production, barrels	410 000	254 000
daily average, barrels per day	1 125	695
Natural gas production, mcf	537 000	89 000
daily average, mcf per day	1 470	245

The above table sets out the Company's working interest production, before deduction of royalties, for the first two full fiscal years the Company was engaged in the oil and gas business. The Company acquired its first substantial production at Lloydminster late in the calendar year of 1973. All of the Company's producing properties are located in Alberta.

The Lloydminster properties produced more than 90 percent of the Company's oil. The remaining oil production was from South Hays and Black Butte. Prorationing, imposed as a result of government export restrictions to the United States, curtailed production at Lloydminster during the first three months of 1976 and again in August. South Hays production was prorated during April and May 1976.

The experimental thermal project involving Company lands in the Lloydminster Sparky K pool at Kitscoty was initiated by the operator on September 2, 1975. The surface facilities and most of the development drilling has now been completed. Scheduled ignition has been postponed until the marketing situation for production from this scheme has clarified and the project may proceed without loss in efficiency due to prorationing. Plans to increase recovery by waterflooding at the Till and Blackfoot leases have been deferred for the same reason.

Natural gas production commenced at North Coleman and fifteen new wells at Princess were put on stream during the fiscal year. A fivefold increase in Company annual average gas production from 245 mcf per day to 1 470 mcf per day resulted. North Coleman was contributing 1 000 mcf per day and Princess 500 mcf per day to Company production at the end of the fiscal year. The remaining gas production was from Bruce, Atlee-Buffalo, Vanalta's production from the Deadwood gas field serving the local market at Manning, Vanalta's overriding royalty interest at Bindloss, and the Medicine Hat properties which were sold at the end of July 1976.

Since the end of the fiscal year, gas production commenced from the Leahurst well in October 1976. Sales from this highly productive well are presently restricted to the requirements of the local Stettler market area served by the purchaser. The well will produce on a routine basis as soon as liquid hydrocarbons produced with this rich natural gas can be handled.

Reserves

	At August 31, 1976			
	OIL, thousand barrels		GAS, thousand mcf	
	Working Interest (1)	Company Net (2)	Working Interest (1)	Company Net (2)
Proven and Producing (3)				
Requiring no capital (4)	3 343	2 737	2 368	1 150
Requiring capital (5)	—	—	16 886	9 898
Subtotal	3 343	2 737	19 254	11 048
Proven but not Producing	6 236	5 177	6 380	3 510
Total proven	9 579	7 914	25 634	14 558
Probable (6)	8 040	6 493	1 855	1 059
TOTAL PROVEN PLUS PROBABLE	17 619	14 407	27 489	15 617

(1) before deduction of royalties
(2) after deduction of royalties
(3) currently being produced
(4) no additional capital expenditures required in order to produce the reserves at the forecast rates
(5) additional capital expenditures required in order to produce the reserves at the forecast rates
(6) no adjustment made for risk

The reserves of the Company have been evaluated by a recognized independent consultant. All of the Company's reserves are located in Alberta. In addition to the oil and gas reserves presented in the table, 78 270 long tons of sulphur will be produced as a by-product from the Company's gas reserves at North Coleman.

"Proven reserves" are considered to be those reserves that, to a high degree of certainty, are recoverable at commercial rates, under present producing methods and current operating conditions, prices and costs.

"Probable reserves" are considered to be those reserves commercially recoverable as a result of the beneficial effects which may be derived from the future institution of some form of pressure maintenance or other secondary recovery method, or as a result of a more favourable performance of the existing recovery mechanism than that which would be deemed proven at the present time, or those reserves which may be reasonably assumed to exist because of geophysical or geological indications and drilling done in regions which contain proven reserves.

The consultant's appraisals indicate the Company's properties at August 31, 1976 are capable of producing an undiscounted "net production revenue" from proven reserves alone of more than $80 million with a present worth value before tax, discounted at 12 percent, of more than $26 million. "Net production revenue" is income derived from the sale of net reserves of oil, gas, and gas by-products less all capital and operating costs.

Auditors' Report

To the Shareholders of
Canadian Hidrogas Resources Ltd.:

We have examined the consolidated balance sheet of Canadian Hidrogas Resources Ltd. as at August 31, 1976, and the consolidated statements of loss, retained earnings and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, subject to the successful defense of the lawsuit described in Note 7(b), these consolidated financial statements present fairly the financial position of the company as at August 31, 1976 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

DELOITTE, HASKINS & SELLS
Chartered Accountants.

December 20, 1976.

consolidated statement of retained earnings

For the year ended August 31, 1976 *(with prior year figures for comparison)*

	1976	1975 (Restated Note 2)
RETAINED EARNINGS AT BEGINNING OF THE YEAR:		
As previously reported	**$552,397**	$972,010
Restatement of prior period figures (Note 2)	**98,825**	40,833
As restated	**453,572**	931,177
NET LOSS FOR THE YEAR	**314,933**	477,605
RETAINED EARNINGS AT END OF THE YEAR	**$138,639**	$453,572

The accompanying notes are an integral part of the consolidated financial statements.

consolidated statement of loss

For the year ended August 31, 1976 *(with prior year figures for comparison)*

	1976	1975 (Restated Note 2)
SALES AND OPERATING REVENUE	**$3,812,844**	$1,760,048
EXPENSES:		
Cost of sales and operating expenses	**2,083,297**	1,018,753
Selling, general and administrative expenses	**511,119**	324,300
Interest — on long-term debt	**589,654**	302,192
— on short-term debt	**42,075**	6,038
Depreciation, depletion and amortization	**343,430**	180,720
Minority interest in earnings of a subsidiary	**2,885**	2,909
Total expenses	**3,572,460**	1,834,912
INCOME (LOSS) FROM ON-GOING OPERATIONS	**240,384**	(74,864)
LOSS ON OPERATIONS DISCONTINUED DURING THE YEAR (Note 2 (b))	**—**	422,256
INCOME (LOSS) BEFORE INCOME TAXES AND EXTRAORDINARY ITEM	**240,384**	(497,120)
INCOME TAXES (Note 5):		
Current	**—**	(597,496)
Deferred	**167,676**	644,010
Provincial rebates — current	**(117,495)**	(41,806)
— deferred	**(52,974)**	(24,223)
Net income taxes	**(2,793)**	(19,515)
NET INCOME (LOSS) BEFORE EXTRAORDINARY ITEM	**243,177**	(477,605)
LOSS ON DISPOSAL OF ASSETS OF OPERATIONS DISCONTINUED IN PRIOR YEAR — net of current income taxes of $17,250 and deferred income taxes of $385,674	**558,110**	—
NET LOSS FOR THE YEAR	**$ 314,933**	$ 477,605
EARNINGS (LOSS) PER SHARE (Note 8):		
Before extraordinary item	**8.9¢**	(17.7)¢
After extraordinary item	**(11.6)¢**	(17.7)¢

The accompanying notes are an integral part of the consolidated financial statements.

consolidated statement of changes in financial position

For the year ended August 31, 1976 *(with prior year figures for comparison)*

	1976	1975 (Restated Note 2)
WORKING CAPITAL PROVIDED:		
From on-going operations	$ 697,722	$ 158,025
From operations discontinued during the year (Note 2(a))	—	526,523
Increase in long-term debt	4,389,200	4,778,000
Issue of capital stock on acquisition of shares of subsidiary company	11,462	44,987
Total working capital provided	5,098,384	5,507,535
WORKING CAPITAL UTILIZED:		
Acquisition of gas, oil and mineral interests	1,199,824	2,391,025
Additions to transportation and other equipment	154,389	31,974
Paid or payable on long-term debt	2,908,559	1,859,966
Acquisition of shares of subsidiary company	22,500	89,077
Repurchase of capital stock	19,695	—
Financing costs deferred	—	71,978
Net current assets of operations discontinued in prior year	943,784	—
Total working capital utilized	5,248,751	4,444,020
(DECREASE) INCREASE IN WORKING CAPITAL	(150,367)	1,063,515
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF THE YEAR:		
As previously reported	343,627	(147,315)
Restatement of prior period figures (Note 2)	(26,058)	(598,631)
As restated	317,569	(745,946)
WORKING CAPITAL AT END OF THE YEAR	$ 167,202	$ 317,569

The accompanying notes are an integral part of the consolidated financial statements.

c solidated balance sheet

as ugust 31, 1976 *(with prior year figures for comparison)*

Assets

	1976	1975 (Restated Note 2)
C NT ASSETS:		
and short-term deposits	**$ 499,205**	$ 335,434
unts receivable:		
ade	**675,799**	1,860,094
vincial rebates	**157,432**	41,806
ntories — at the lower of average cost net realizable value	**298,639**	1,206,384
aid expenses and deposits	**37,414**	42,241
ketable securities narket value $33,687; 1975 — $25,437)	**29,562**	29,562
Total current assets	**1,698,051**	3,515,521
P ERTY AND EQUIPMENT:		
, oil and mineral interests	**7,862,317**	6,644,395
nsportation equipment	**371,939**	204,694
er equipment	**165,478**	178,334
Total cost of property and equipment	**8,399,734**	7,027,423
s accumulated depreciation and depletion	**582,867**	274,491
Net property and equipment	**7,816,867**	6,752,932
D RRED FINANCING COSTS — net of amortization	**94,325**	124,658
TOTAL	**$9,609,243**	$10,393,111

Approved By The Board:

Director

Director

Th e accompanying notes are an integral part of the consolidated financial statements.

Liabilities and Shareholders' Equity

	1976	1975 (Restated Note 2)
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	**$1,309,236**	$ 2,682,552
Current portion of long-term debt	**221,613**	515,400
Total current liabilities	**1,530,849**	3,197,952
LONG-TERM DEBT — less portion included in current liabilities (Note 3)	**6,222,374**	4,741,733
DEFERRED INCOME TAXES	**643,171**	914,143
MINORITY INTEREST	**72,384**	75,652
SHAREHOLDERS' EQUITY:		
Capital stock:		
Authorized:		
5,000,000 common shares with a par value of $1 each		
Issued and fully paid (Note 4):		
2,723,139 shares (1975 — 2,716,589 shares)	**896,984**	890,434
Repurchased — 19,200 shares	**(19,695)**	—
Net capital stock issued	**877,289**	890,434
Contributed surplus — arising on issue of common shares	**124,537**	119,625
Retained earnings	**138,639**	453,572
Total shareholders' equity	**1,140,465**	1,463,631
TOTAL	**$9,609,243**	$10,393,111

notes to the consolidated financial statements
August 31, 1976

1. SUMMARY OF SIGNIFICANT ACCOUNTING PRACTICES:
   a) These consolidated financial statements include the accounts of the parent company and those of its wholly-owned subsidiaries, Hidrogas Limited, Hidrogas Incorporated, Pet Chem Distributing Ltd., Hidrogas Inc., and its 75% owned subsidiary, Vanalta Resources Ltd.

      During the year the Company acquired an additional 2.2% interest in the voting shares of its subsidiary Vanalta Resources Ltd. for cash of $11,038 and 6,550 shares of the Company valued at $1.75 per share for a total consideration of $22,500.
   b) The Company follows the full cost method of accounting for its resources properties whereby costs of exploring for and developing oil and gas reserves are capitalized and these costs are depleted or depreciated on a unit of production basis based on proven oil and gas reserves.

      Depreciation of transportation and other equipment is computed under the declining balance method at rates of 4% and 20% to 30% respectively. These rates are intended to amortize the cost of these assets, net of residual value, over their estimated useful lives.
   c) The Company follows the practice of capitalizing financing costs on issuance of long-term debt and amortizing such amounts on a straight-line basis over the term of the related debt.
2. RESTATEMENT AND RECLASSIFICATION OF PRIOR PERIOD FIGURES:
   a) During the year, the Company was reassessed by income tax authorities on both income tax and other tax returns filed in prior years. The comparative 1975 figures have been retroactively restated to show the effects of these reassessments, and the closing balance of retained earnings at August 31, 1975 has been reduced by the following:

Deferred income taxes	$(557,798)
Current income taxes	588,565
Other taxes	10,066
Applicable to 1974 and prior years	40,833
Deferred income taxes	588,565
Current income taxes	(588,565)
Interest on late tax payments	36,316
Provincial rebates — current	21,676
Applicable to 1975	57,992
Net reduction of retained earnings at August 31, 1975	$ 98,825

   b) During the prior year, the Company terminated activity in the merchandising of liquified petroleum gas and related products. The 1975 figures have been reclassified to reflect for comparative purposes those 1975 operations which continued in 1976. A summary of the restated 1975 results of discontinued operations follows:

Sales	$13,726,425
Cost of sales	12,699,646
Selling, general and administrative expenses	934,739
Interest on short-term debt	149,043
Depreciation	5,039
Excess of purchase price of subsidiaries over net assets acquired	360,214
Total expenses	14,148,681
Loss on operations discontinued during the year, before income taxes	$ 422,256

c) Certain additional 1975 figures have been reclassified to conform to the current year's presentation.

3. LONG-TERM DEBT: (See also Note 9)

	1976	1975
Details of long-term debt are as follows:		
Production loan, interest at $1\frac{3}{4}\%$ above prime rate, declining to $1\frac{1}{2}\%$ above prime rate July, 1978, at which time repayment commences in equal monthly installments including interest, such that principal will be repaid on a graduated basis from 15% to 25% per year for 5 years (Note 9)	**$4,000,000**	$ —
Production loans, interest at $1\frac{1}{2}\%$ above prime rate, to be repaid in equal monthly installments including interest over 5 years	—	3,014,333
9% convertible debenture, due 1983, interest payable quarterly, convertible into common shares of the Company at the rate of 690 shares for each $1,000 principal (Note 9)	**1,000,000**	1,000,000
12% debenture, maturing 1980, repayable at $5,600 per month plus interest (Note 9)	**893,600**	960,800
Mortgage payable, non-interest bearing, repayable in annual installments of $65,000 decreasing to a final installment of $54,000 July 1, 1979	**179,000**	249,000
$12\frac{1}{2}\%$ chattel mortgage, repayable in equal monthly installments of $10,101 including interest, maturing March, 1980	**350,387**	—
Agreement payable, non-interest bearing, maturing 1978, repayable in monthly installments of $1,000	**21,000**	33,000
	6,443,987	5,257,133
Current portion of long-term debt	**221,613**	515,400
	$6,222,374	$4,741,733

The production loan is secured by a first charge against certain gas, oil and mineral interests. The 9% debenture is secured by a second charge against certain gas, oil and mineral interests and by a floating charge on all other assets of the Company. The 12% debenture is secured by a floating charge on all assets of the Company and a fixed charge on certain gas, oil and mineral interests. The mortgage payable is secured by a second charge against certain gas, oil and mineral interests. The $12\frac{1}{2}\%$ chattel mortgage is secured by the transportation equipment.

4. CAPITAL STOCK:

Details of issued capital are as follows:	Number of Shares	At Par of $1	Discount	Net	Contributed Surplus
Balance August 31, 1975	2,716,589	$2,716,589	$1,826,155	$890,434	$119,625
Issued on acquisition of shares of Vanalta Resources Ltd. (Note 1)	6,550	6,550	—	6,550	4,912
Balance August 31, 1976	2,723,139	$2,723,139	$1,826,155	$896,984	$124,537

The Company has reserved 300,000 shares for issuance to officers and employees under a stock option plan. Options in respect of 140,000 shares have been granted at a price of $1 per share and may be exercised to acquire up to 20% annually of the shares under option on a cumulative basis until 1979 on 35,000 shares, to 1980 on 35,000 shares and to 1981 on 70,000 shares.

The Company has granted non-transferable stock purchase warrants to two individuals for a total of 50,000 shares at $2 per share, exercisable until February, 1979.

The Company has entered into an Option Agreement with a debenture holder who has the option to purchase 300,000 shares of the Company at a price of $1.60 per share, exercisable until December 31, 1978 (Note 9).

None of the above stock options or stock purchase warrants have been exercised to date.

5. INCOME TAXES:

The Company is allowed to claim certain deductions from income for income tax purposes, and conversely certain expenses may not be claimed, in arriving at taxable income. The major difference between income before income taxes and extraordinary item, and income subject to tax are as follows:

	1976	1975
Income (loss) before income taxes and extraordinary item	**$240,384**	$(497,120)
Add:		
Royalties not deductible for tax purposes but to which provincial rebates apply	**456,994**	129,560
Loss of subsidiary, on which recovery of future years income taxes is uncertain	—	103,190
Excess of purchase price of subsidiaries over net assets acquired	—	360,214
	697,378	95,844
Deduct:		
Depletion and resource allowances	**354,335**	—
Income subject to tax	**$343,043**	$ 95,844

A subsidiary company incurred a tax loss of approximately $178,000, which amount is included in the extraordinary item. This loss, together with prior tax losses of $184,000 may be utilized until 1981 and 1979 respectively to reduce future taxable income. The income tax reductions from the use of these losses (if any) will be recorded when the losses are utilized.

6. REMUNERATION OF DIRECTORS AND OFFICERS:

Remuneration of directors and senior officers of the Company amounted to $141,575 (1975 — $144,677). These amounts include the remuneration paid to the following:

	1976	1975
Directors who also serve as officers	**5**	4
Other employees, defined as senior officers under The Companies Act, British Columbia	**2**	3

7. CONTINGENT LIABILITIES AND COMMITMENTS:

a) The Company has entered into a five year lease expiring in 1977 for certain transportation equipment at an annual rental of $131,950.

b) A former supplier has commenced an action against the Company and the U.S. Federal Energy Administration in the Federal District Court, District of California, seeking damages of $896,000 (U.S.) resulting from prices paid for certain liquefied petroleum products purchased by the Company under the regulations of the U.S. Federal Energy Administration. The Company and its solicitors are of the opinion that the action can be successfully defended and no provision for this amount has been made in these financial statements.

8. EARNINGS PER SHARE:

Earnings per share have been calculated on the weighted average number of shares outstanding during the year.

The potential dilutive effect of the stock options and warrants referred to in Note 4 and conversion privileges on the 9% debenture referred to in Note 3 are not significant.

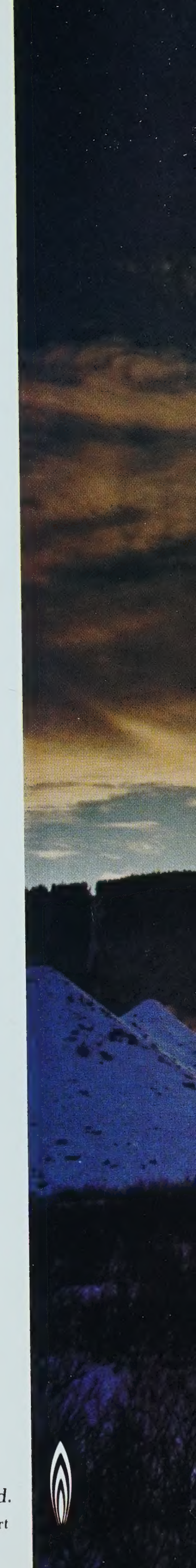
9. SUBSEQUENT EVENTS:

During the year, the Company negotiated a production loan in the amount of $7,000,000 of which $4,000,000 had been received as at August 31, 1976.

The Company has concluded negotiations with the present debenture holders whereby, in exchange for 100,000 fully paid shares of the company (19,200 comprising shares previously purchased by the company and 80,800 comprising unissued shares), the debentures referred to in note 3 will be repaid from further proceeds of the production loan, the conversion rights attached to the 9% convertible debenture will be eliminated and the debenture holder's option agreement for 300,000 shares referred to in note 4 will be cancelled.

Upon completion of these transactions both working capital and long-term debt of the Company will increase by $1,106,400, and principal repayments on long-term debt will be due as follows:

1977	$ 154,413
1978	233,913
1979	1,181,413
1980	1,156,580
1981	1,469,901
1982 and later	3,354,167
	$7,550,387



Canadian Hidrogas Resources Ltd.

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